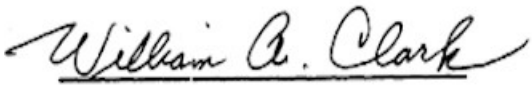

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION AT DAYTON

In re:	*	
		Case No. 02-30956
Isagani T. Hernandez and	*	
Haydee L. Hernandez,		Chapter 7
	*	
Debtors.		Judge William A. Clark
	*	

MEMORANDUM DECISION DENYING TRUSTEE'S OBJECTION TO EXEMPTION OF DEBTOR'S KEOGH PLAN AND FINDING THAT DEBTOR'S KEOGH PLAN IS EXCLUDED FROM THE BANKRUPTCY ESTATE

Dated at Dayton, Ohio this 16th day of November, 2005:

This matter is before the court on the Trustee's Objection to the Debtors' Claimed Exemption Relating to a Keogh Plan, [Doc. # 241], and the Debtors' Response to the Trustee's Objection, [Doc. # 242]. In support of their positions, the parties also filed primary and response briefs with the court. [*See* Doc. #s 279, 280, 281, 282 & 283.] The court heard the arguments of the parties at a hearing on September 29, 2005 and took the matter under advisement at that time.

The court has jurisdiction over this matter pursuant to 28 U.S.C. § 157 and 1334 and the standing order of reference entered in this district. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2).

I. Factual Background

The parties stipulated to certain facts prior to the hearing on this matter. Those stipulations included over 500 pages of supporting documentation. [*See* Doc. #s 277, 278.] The court will provide a brief summary of the relevant information here.

Debtor Isagani Hernandez ("Hernandez") is a physician with a general practice located in Xenia, Ohio. Debtor Haydee Hernandez works in real estate and is married to Dr. Hernandez. Dr. Hernandez has been in continuous practice since 1968 and is the sole proprietor of his unincorporated business.

In 1981, Dr. Hernandez established the I.T. Hernandez, M.D. Keogh Plan in the Bank One, N.A., Standardized Profit Sharing Plan (the "Plan"). Dr. Hernandez is the employer for purposes of the Plan and serves as the plan administrator. The assets in the Plan have been, and continue to be, managed by Bank One Trust Company, N.A. Bank One serves as the custodian for the Plan. Since the inception of the Plan in 1981 through the present date, Dr. Hernandez has been the only contributor to the Plan. The Debtor did not, however, contribute to the Plan in several years prior to or the year of the bankruptcy filing.

According to the terms of the Plan, employees become "eligible to participate in the Plan once [they] have attained age 21 and completed two Years of Service." I.T. Hernandez, M.D. Keogh Plan Summary Plan Description ("Plan Summary"), Jt. Stip., Ex. 4, p. 1. Once eligible, however, an employee may begin participating in the Plan on "the first day of the Plan Year preceding the date [the employee] meet[s] the eligibility requirements …." Plan Summary, p. 2.

In July 2000, the Debtor employed Sharon Davis, the only employee to ever become eligible. Ms. Davis was continuously employed for at least two years through July 2002. As such, Ms. Davis met the eligibility requirements of the Plan in July 2002 and became eligible to participate in the Plan at the beginning of the 2002 Plan Year on January 1, 2002. The Debtor never made any contributions to the Plan for Ms. Davis.

At the end of the 2002 Plan Year, the total assets held in the Plan had a value of $791,098.00. The Debtors filed a petition under chapter 11 of the Bankruptcy Code on February 13, 2002. The case was converted from a chapter 11 to a chapter 7 bankruptcy on June 8, 2004.

The Trustee's Objection was filed on December 7, 2004 and, after the parties conducted discovery on the issues raised, the court heard oral arguments on September 29, 2005.

II. Discussion

The issue before the court is whether Debtor Isagani Hernandez's Keogh Plan is property of the estate under 11 U.S.C. § 541. Section 541(c)(2) states that "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title." The parties agree that the Plan is a beneficial interest of the debtor in a trust that contains a restriction on its transfer, but they disagree on whether the restriction is enforceable under nonbankruptcy law.

The Trustee argues that the restriction is not enforceable because it is not effective under Ohio state law or any other "applicable" law, specifically the federal Employee Retirement Income Security Act of 1974 ("ERISA"). The Trustee's position is that the Plan is not subject to ERISA and therefore the provisions of ERISA cannot be applied to enforce the anti-alienation provisions of the Plan. The Debtors admit that the restriction in the Plan is not enforceable under

Ohio state law, but argue the Plan is subject to ERISA and the restriction is enforceable under its provisions.

The court agrees with the parties that the restriction on alienation in this Plan is not enforceable under Ohio state law. This Plan is considered a self-settled trust under Ohio trust law and Ohio courts have consistently invalidated anti-alienation provisions in such trusts.

It is also well settled that ERISA meets the definition of "nonbankruptcy law" as described in § 547(c)(2) and can operate to prevent the transfer of trust assets to a bankruptcy estate. The issue remains, however, of whether this Plan is subject to ERISA. If it is, then ERISA's transfer restrictions can be applied to prevent the assets of Plan from becoming part of the Debtor's bankruptcy estate.

A. Legal Background

The interaction between section 541 of the Bankruptcy Code and ERISA has been well-litigated. The Supreme Court resolved a conflict in the federal circuit courts of appeals in 1992 with the decision in *Patterson v. Shumate*, 504 U.S. 753 (1992). In *Patterson*, the Court ruled that the term "other bankruptcy law" in § 541 included not only state law but federal law as well, *e.g.* ERISA. *Patterson*, 504 U.S. at 758. The Court also decided specifically that the anti-alienation provision required for ERISA qualification constituted an enforceable transfer restriction for purposes of § 541. *Id.* at 759.

The progeny of *Patterson* in the lower courts quickly developed and defined the term "ERISA qualified plan" to describe the situation where a plan should be excluded from the bankruptcy estate under § 541. This court spoke on the issue in *In re Foy*, 164 B.R. 595 (Bankr. S.D. Ohio 1994). In the *Foy* case, this court held that a plan is ERISA qualified and therefore excluded from the bankruptcy estate if:

1. The plan is subject to ERISA;

2. The plan includes an anti-alienation provision as required by ERISA; and

3. The plan is tax qualified under Section 401(a) of the Internal Revenue Code.

In re Foy, 164 B.R. at 597.[1]

More recently, a trend emerged in the bankruptcy courts in which "self-settled" retirement plans where the owner and sole shareholder of a corporation or company was the beneficiary of the plan were found to be included in the estate.[2] The reasoning behind this trend was that although the plan itself was subject to ERISA, the owner or sole shareholder as a debtor in bankruptcy could not exclude the plan from the estate because the plan covered only the working owner.

The working owner qualification issue was in dispute until the Supreme Court's decision in *Yates v. Hendon*, 541 U.S. 1 (2004). In the *Yates* case, the Court held that a sole shareholder of a corporation could qualify as a participant in an ERISA pension plan sponsored by his corporation, so long as the plan covered one or more employees other than himself and his wife. *Yates*, 541 U.S. at 12. Thus, under *Yates*, a plan in which the sole shareholder or owner of an organization and his or her spouse are the only persons covered by the plan falls outside the domain of ERISA.

The parties in the present case have couched their arguments in this body of law. The parties agree that the Plan in this case contains an anti-alienation provision a required by *Foy*.

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[1] The parties disagree on the test that should be applied in this case. The Trustee relies on a test from *In re Wilcox*, 233 F.3d 899, 904 (6th Cir. 2000). The *Wilcox* test addresses whether a participant's interest in a retirement plan is part of the bankruptcy estate. The *Foy* test addresses the specific issue of whether a participant's interest in a pension plan should be part of the estate based on ERISA law. The two tests do not disagree with each other, but address slightly different issues.

[2] The court uses the term "self-settled" loosely. Other terms meaning the same type of plan include "working owner," "employee owner," and "one person" plans. As is mentioned in the text, the key is that the plans in question only have one beneficiary.

The Debtor, however, is the sole proprietor of his medical business, is the administrator of the Plan, and is the sole beneficiary of the Plan.

The Trustee thus argues that the Plan falls directly under the ruling in *Yates*. Under *Yates*, if the Debtor is the only person covered by the Plan, then he does not qualify as a participant under ERISA. And the Plan is not subject to ERISA thereby leaving the proceeds of the Plan to be a part of the bankruptcy estate.

The Debtor, however, argues that although he is the only beneficiary of the Plan, he is not the only person covered by the Plan. The Debtor points to a former employee of the Debtor, Sharon Davis, who was eligible to participate in the Plan in 2002 and argues that Ms. Davis' eligibility makes her a "participant" in the Plan under ERISA. As such, the Debtor argues that since the Debtor was not the only person covered under the Plan, the Plan meets the requirements of the Supreme Court's ruling in *Yates*, and the assets in the Plan should be excluded from the estate.

B. Definition of Participant

The primary issue before the court is whether Ms. Davis was a participant in the Plan.[3] If she was, then the Debtor was not the sole participant in the Plan, the Plan is subject to ERISA, the Plan's anti-alienation provision is operable, and the proceeds of the Plan are excluded from the bankruptcy estate. If Ms. Davis was not a participant in the Plan, then the Debtor is the only person covered by the Plan and the assets in the Plan will be included in the bankruptcy estate.

[3] The court recognizes that the parties stipulated to the fact that at all times from 1981 through the petition date, the Debtor was the only "participant" in the Plan. Both parties recognize this in their briefs and the Trustee alludes to the fact that the Debtor's argument hinges on the court's interpretation of a statutory definition that the Debtor arguably stipulated to in the Trustee's favor. The court, however, finds that the parties used the term "participant" in the stipulations as it is commonly defined, and not as it is defined in ERISA. The question of whether Ms. Davis was a "participant" in the Plan as defined by ERISA is a question of law and the court is not required to adhere to the parties' stipulations in that regard. *See Estate of Charles Henry Sanford v. Commissioner*, 308 U.S. 39, 51 (1939)("We are not bound to accept, as controlling, stipulations as to questions of law.").

At the outset of this analysis, the court considered the "reality" of the situation. Ms. Davis, although potentially a "participant" in this Plan under ERISA, is not presently a beneficiary of the Plan. Not only is she not a current beneficiary, but she never was. During the time that Ms. Davis was eligible to participate in the Plan, the Debtor made no contributions to the Plan. Based on the evidence before the court, it is uncertain whether Ms. Davis even knew the Plan existed. Thus, at first blush, the issue appeared simple. If Ms. Davis is not and never was able to receive money from the Plan because the employer made no contribution to the Plan for her during her period of eligibility, then the conclusion that Ms. Davis was a participant in the Plan is not logically possible.

Despite this "reality" check, the court is reminded of ERISA's primary goals to protect pension benefits and to provide for uniform national treatment of those plans. *Patterson*, 504 U.S. at 764-65 (citing *Guidry v. Sheet Metal Workers Nat. Pension Fund*, 493 U.S. 365 (1990)); *Yates*, 541 U.S. at 16 (quoting *Patterson* and also stating that ERISA's purpose is to "promote and facilitate employee benefit plans"). Thus, this court went beyond its initial impressions and looked to the definition of participant in the Plan itself and to ERISA and its supporting regulations to determine whether Ms. Davis was ever covered under the Plan.

The Plan itself is a standardized Bank One profit sharing plan. The Debtor is the administrator of the Plan and has complete discretion in making contributions to the Plan. The documentation before the court regarding the Plan includes the Plan Summary, a standardized adoption agreement, a basic plan document from February 1990, a basic plan document from December 2001, the Plan itself and several amendments to the Plan.

The Plan Summary contains a section on participation in the plan. Under the question "Am I eligible to participate in the Plan?" the summary states that "you are eligible to participate

in the Plan once you satisfy the Plan's eligibility conditions described in the next question." The next question is "When am I eligible to participate in the Plan?" to which the summary responds, "You will be eligible to participate in the Plan once you have attained age 21 and completed two Years of Service." Plan Summary, p. 1. Thus, the Plan Summary indicates that an employee is eligible to participate in the Plan immediately upon the completion of two years of service.

The two basic plan documents contain definition sections. The basic plan document dated February 1990 states that the definition of participant is "[a]ny employee who has met the eligibility requirements and is participating in the Plan." Prototype Defined Contribution Plan and Trust/Custodial Account, Ex. B, Article I, Section 1.40, p. 8, found in Jt. Stip., Ex. 3, Transcript of Haydee Hernandez Rule 2004 Examination.

The basic plan document dated September 2001 and effective beginning at January 1, 2002, differs from the earlier version. The definition of participant states that "[a] Participant is an Employee or former Employee who has satisfied the conditions for participating under the Plan." Bank One Defined Contribution Plan and Trust, Basic Plan Document, Ex. C, Article 22, Section 133, p. 129, found in Jt. Stip., Ex. 3, Transcript of Haydee Hernandez Rule 2004 Examination. Thus, as of January 2002, the basic plan document defined a participant as one who was eligible for participating in the Plan, regardless of whether one had assets in the Plan.

The remaining plan documents provide a wealth of information on the Plan itself, but little guidance on the definition of participant under the Plan. Thus, under the terms of the Plan itself, Ms. Davis became eligible after working for two years for the Debtor in July 2002.[4] And, at that time, she was a participant in the Plan.

[4] As discussed above, Ms. Davis reached the two year service point in July 2002. Under the terms of the Plan, she therefore became eligible to participate in the Plan at the beginning of the plan year in which she reached the two year service point, or January 1, 2002.

Going beyond the Plan itself, the court also reviewed the definition of participant under ERISA. ERISA defines a participant as:

> any employee or former employee of an employer, or any member of former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit.

29 U.S.C. § 1002(7). Although ERISA's definitions have been called "uninformative" by other courts, *see Yates*, 541 U.S. at 12, this court reads that definition as broad, but fairly clear. A participant is one who is or may become eligible to receive a benefit from a plan.

In addition to the definitions in ERISA, the Department of Labor has set forth regulations implementing ERISA. *See id.* at 18-19 (utilizing 29 C.F.R. § 2510.3-3 to analyze the issue of employee-owner participation). In 29 C.F.R. § 2510.3-3, the Department of Labor provides an explanation of which plans will be covered under ERISA. Addressing Keogh plans such as this, the regulation states that:

> a so-called 'Keogh' or 'H.R. 10' plan under which only partners or only a sole proprietor are covered under the plan will not be covered under Title I. However, a Keogh plan under which one or more common law employees, in addition to the self-employed individuals, are participants covered under the plan, will be covered under [ERISA].

29 C.F.R. § 2510.3-3(b). In addition, the regulation states that an individual becomes a participant covered under an employee pension plan on the "date designated by the plan as the date on which the individual has satisfied the plan's age and service requirements for participation." 29 C.F.R. § 2510.3-3(d)(1)(ii)(A)(2).

Thus, under ERISA itself and the regulations implementing ERISA, Ms. Davis was clearly a participant in the Plan because she was *eligible* to participate in the Plan. As with the definitions found in the Plan itself, this determination is separate and distinct from whether a

contribution was made for Ms. Davis to the Plan or whether she was only a potential beneficiary of the Plan.

Having done the analysis of whether Ms. Davis was a participant in the Plan based on the language of the Plan and ERISA, the court finds that the determination of whether Ms. Davis was a participant in the Plan is based not on her status as a beneficiary or even on her actual participation, but on her eligibility for participation in the Plan. Thus, according to the plain language of the Plan and ERISA, Ms. Davis was eligible to participate in the Plan and will be considered a participant for the purposes of this bankruptcy.

Notably, the Trustee does not disagree with this conclusion. In his reply brief, the Trustee states that Ms. Davis was technically eligible to participate in the Plan. The Trustee does disagree, however, that Ms. Davis' eligibility should be determinative of whether the Plan is subject to ERISA. Instead, the Trustee asks the court to look beyond the plain language of the statute and the Supreme Court's opinion in *Yates* and find that the Plan is not covered by ERISA because Ms. Davis was never a beneficiary of the Plan and, perhaps more importantly, that the Debtor was always the sole beneficiary of the Plan.

While the court agrees with the Trustee that the Debtor is and always has been the sole beneficiary of the Plan, the court will not ignore the plain meaning of ERISA, the Department of Labor regulations, and the *Yates* opinion. This Plan is subject to ERISA and the anti-alienation provisions of ERISA keep the assets of the Plan outside of this bankruptcy estate.

This is the case even though the Debtor failed to make a contribution while Ms. Davis was a participant in the Plan and failed to properly abide by the requirements of the Plan. The Trustee points to the fact that although the Internal Revenue Service issued an opinion letter that

accepted the form of the Plan on November 27, 2001, the administrator/working owner/Debtor apparently failed to meet the top-heavy requirements of the Plan in its operation.

The court is not swayed by these arguments. The Debtor's failure to properly operate the Plan does not preclude the Plan from being subject to the protections of ERISA. This result is supported by a large body of case law finding that a debtor's failure to operate a plan under the provisions of ERISA does not preclude the protections of ERISA. *See generally In re Handel*, 301 B.R. 421, 434 (Bankr. S.D.N.Y. 2003) (listing numerous cases).

The *Handel* court stated that "no court appears to have held that a plan fiduciary is estopped from enforcing the anti-alienation provision by his or her breach of the plan and ERISA." *Id.* In *Handel* the court found that a debtor's plan was subject to ERISA despite drastic departures from the requirements of ERISA. The court did so based upon the strong policy of the protection of pension benefits.

Despite the Debtor's failure to properly operate the Plan, this court finds that this Plan is subject to ERISA for the same reasons. ERISA's policy of "ensuring the protection of pension benefits from creditors should not depend on the beneficiary's bankruptcy status." *Id.* at 430 (citing *Patterson v. Shumate*, 504 U.S. 753, 764 (1992)).

III. Conclusion

The court finds that the Debtor's Keogh Plan is subject to ERISA and protected by the anti-alienation provisions within ERISA. Although the Debtor is the sole beneficiary of the Plan, the Debtor was not the only participant in the Plan under the plain meaning of the Plan, ERISA, and the Department of Labor regulations implementing ERISA. Moreover, despite the Debtor's failure to follow the top-heavy requirements of the Plan, his actions do not preclude the Plan from being subject to ERISA.

This Plan is subject to ERISA and the anti-alienation provisions of ERISA ensure that the assets of the Plan are excluded from the bankruptcy estate under 11 U.S.C. § 541. The Trustee's objection is denied.

It is so ordered.

cc:
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